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AZ CORP COMMISSION  
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## BEFORE THE ARIZONA CORPORATION COMMISSION

SUSAN BITTER SMITH  
ChairmanBOB STUMP  
Commissioner

Arizona Corporation Commission

DOCKETED

BOB BURNS  
Commissioner

JUN 01 2015

TOM FORESE  
Commissioner

DOCKETED BY

ORIGINAL

DOUG LITTLE  
Commissioner

IN THE MATTER OF THE JOINT  
APPLICATION OF WILLOW VALLEY  
WATER CO., INC. AND EPCOR WATER  
ARIZONA, INC. FOR APPROVAL OF THE  
SALE OF ASSETS AND TRANSFER OF  
CERTIFICATE OF CONVENIENCE AND  
NECESSITY

W-01732A-15-0131  
W-01303A-15-0131

SUPPLEMENT TO APPLICATION  
SEEKING APPROVAL OF  
RECOVERY OF PRICE PAID IN  
EXCESS OF RATE BASE

On April 22, 2015, Willow Valley Water Company, Inc. ("Willow Valley") and EPCOR Water Arizona Inc. ("EWAZ") filed an application requesting that the Arizona Corporation Commission ("Commission") approve the sale of Willow Valley's utility system and transfer of its Certificate of Convenience and Necessity ("CC&N") to EWAZ (the "Application"). The Application also requested that the Commission approve a mechanism to allow EWAZ's recovery of the going concern value component of the purchase price paid to Willow Valley. After discussions with Utilities Division Staff, EWAZ, in this supplemental filing, describes the surcharge mechanism it respectfully requests the Commission approve as part of this proceeding.

**1. Background**

As stated in the Application, EWAZ seeks recovery of approximately \$226,000 through a surcharge mechanism to be approved as part of the sale of Willow Valley's

1 utility system and transfer of its CC&N to EWAZ. EWAZ believes the recovery of that  
2 portion of the purchase price in excess of Willow Valley's rate base (the "Acquisition  
3 Premium") is appropriate in this instance for the following reasons:

4 (A) Going Concern Value of Willow Valley. The purchase price for the Willow  
5 Valley system reflects the fair market value of the assets and operations being  
6 purchased, including the value of Willow Valley's CC&N, but exceeds the rate  
7 base value of the property, plant and equipment ("PPE") as set out in the Water  
8 Utility Plant schedules attached to the Willow Valley Water Co., Inc. Annual  
9 Report for year ending 12/31/2014. In other words, the payment of a premium for  
10 Willow Valley's PPE over and above the net book value reflects the going  
11 concern value of Willow Valley's operations (i.e., the net book value of the PPE  
12 and the expectation that Willow Valley will be able to earn a continued fair return  
13 on its investment as part of the EWAZ water utility system).

14 (B) Significant investments will be required upon purchase by EWAZ. EWAZ will  
15 need to make significant capital investments to increase the reliability and quality  
16 of the Willow Valley system, such as replacement of non-operational system  
17 valves, installation of a more robust backwash effluent discharge retention system,  
18 and necessary maintenance of storage tanks. EWAZ is willing, in accordance  
19 with the proposal set out below, to implement a 5-year capital improvement  
20 program, which would expend approximately \$200,000 per year of capital in  
21 excess of the System Improvement Benefit ("SIB") investments authorized in  
22 Decision No. 74364 (February 26, 2014), for a total capital investment of between  
23 \$300,000 and \$500,000 annually for the five years following its acquisition of  
24 Willow Valley. The surcharge mechanism described below will allow EWAZ to  
25 earn continuing fair returns following the acquisition in light of these significant  
26 new capital investments.

1 (C) More Reliable Water Service. As a result of the increased capital investment,  
2 existing Willow Valley customers will receive higher quality and more reliable  
3 water service. In addition, customers served by EWAZ will receive a level of  
4 service and support that meets or exceeds the service currently provided by  
5 Willow Valley.

6 (D) Significant Decrease to Cost of Debt. EPCOR Water USA Inc. (EPCOR USA)  
7 has the ability to maintain a stronger credit rating than Willow Valley on a stand-  
8 alone basis. This stronger credit rating will enable EPCOR USA and its operating  
9 subsidiaries, such as EWAZ, to borrow needed funds at a lower cost than would  
10 otherwise be possible for Willow Valley, including any debt used to finance the  
11 future capital investments. Willow Valley's current capital structure includes an  
12 embedded cost of debt of 6.1 percent, whereas EWAZ's current cost of debt is  
13 4.29%. The long-term bond ratings of EPCOR USA and its subsidiary, EWAZ,  
14 are currently A- (S&P) and Baa2 (Moody's).

## 15 2. Proposal

16 The Company has sought to develop a mechanism that supports the Commission's  
17 desire to accelerate the consolidation of small, troubled water systems or systems with  
18 demonstrated needs for capital improvements to better provide safe and reliable water  
19 service with minimal impacts to customers. The mechanism recommended for approval  
20 by the Commission does not specifically include the Acquisition Premium in rate base, but  
21 rather provides an incentive for companies, including in this instance, EWAZ, to acquire a  
22 small water company with demonstrated needs for capital improvements and to invest in  
23 needed infrastructure at heightened levels through the adjustment mechanism set out below  
24 (the "Acquisition Adjustment").

25 The amount sought to be recovered through the Acquisition Adjustment is the  
26 difference between the going concern/fair market value of Willow Valley, as reflected in

the purchase price, and the original cost of the plant, property, and equipment being acquired less accumulated depreciation (the Net Utility Plant in Service), further reduced by the recorded values of property contributed or advanced by others.

The following calculation sets out the amount sought to be recovered under the above definition:

Net Utility Plant in Service	\$2,796,377
Less: Advances and Contributions	(\$ 528,346)
	\$2,268,031
Purchase Price	\$2,494,834
Less:	(\$2,268,031)
Acquisition Premium	\$ 226,803

The table below illustrates several scenarios under which the Commission could authorize recovery of the Acquisition Premium. This Acquisition Adjustment would be recovered through a monthly surcharge over 10, 12, or 15 years, with recovery of the surcharge phased-in (and the surcharge adjusted on an annual basis) as the additional capital expenditures are made and projects completed. Because the expenditures would be made over a period of five years, and because the recovery time frame would be limited, the surcharge will not permit over recovery.

5-Year Capital Spend	% Commission Authorized Incentive	\$ Authorized Incentive	Annual Operating Income Produced	Annual Revenue Required
\$ 1,000,000	10.00%	\$100,000	\$ 6,740	\$11,054
\$ 1,000,000	15.00%	\$150,000	\$10,110	\$16,580
\$ 1,000,000	20.00%	\$200,000	\$13,480	\$22,107

In the above scenario, EWAZ would commit to spend \$1,000,000 over five years in the Willow Valley system for projects not outlined in the existing SIB. EWAZ is currently evaluating the Willow Valley system to develop a long-term capital plan but has identified

several projects which will be further reviewed, including 1) a system interconnect between the King Street and Lake Cimarron areas of the existing Willow Valley system to provide operational flexibility and redundancy, 2) replacement of system valves that are currently non-operational, 3) a more robust backwash effluent discharge retention system to prevent leaching into the aquifer, 4) necessary maintenance of three storage tanks, and 5) replacement or repair of failed flow and backwash meters and other infrastructure projects.

A Commission approved 20% incentive would provide for an increase to annual operating income as shown above. The required revenues, providing for increases to income and property taxes, are also shown.

% Commission Authorized Incentive	10-Year Operating Income	% of Premium Recovered	12 - Year Operating Income	% of Premium Recovered	15-Year Operating Income	% of Premium Recovered	Cost to customer monthly	% of Typical Bill @5k Gal
10.00%	\$67,400	29.72%	\$80,880	35.66%	\$101,100	44.58%	\$0.61	1.11%
15.00%	\$101,100	44.58%	\$121,320	53.49%	\$151,650	66.86%	\$0.91	1.66%
20.00%	\$134,800	59.43%	\$161,760	71.32%	\$202,200	89.15%	\$1.21	2.22%

The table above demonstrates how the Acquisition Adjustment will lead to partial recovery of the Acquisition Premium. The circled area shows that an authorized incentive of 20% above planned SIB capital expenditures would provide for 89.15% recovery of the Acquisition Premium via an eventual surcharge of \$1.21 per month over a 15-year period. The impact to customers would be approximately a 2.22% increase, or about a \$1.21 per month increase to the average bill.

### 3. Summary

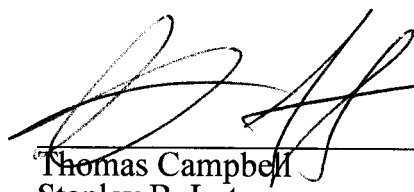
If approved by the Commission, EWAZ would work with Commission Staff to create standard reporting procedures to monitor annual progress of the additional capital projects, and to phase in the surcharge as projects are completed. In addition, EWAZ would provide a report to Commission Staff annually, summarizing total surcharge

1 revenues collected and provide for early termination of the surcharge should full recovery  
2 of the Acquisition Premium occur prior to the authorized term of recovery. EWAZ would  
3 not expect the surcharge to continue further than the originally-authorized term, and would  
4 accept the risk of non-recovery of the full Acquisition Premium upon expiration of the  
5 authorized surcharge period.

6 EWAZ respectfully requests that the Commission authorize the proposed  
7 Acquisition Adjustment to allow for recovery of the going concern value paid for Willow  
8 Valley and approve the concept to allow for timely recovery of such amounts in future  
9 acquisitions in order to further the Commission's stated desire to accelerate the  
10 consolidation of small and/or troubled water systems.

11 RESPECTFULLY SUBMITTED this 29th day of May, 2015.

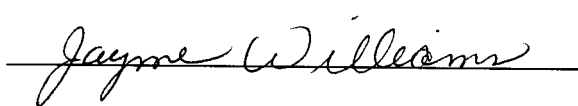
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23 ORIGINAL AND thirteen (13) copies  
24 of the foregoing hand-delivered this  
25 29th day of May, 2015, to:

26 The Arizona Corporation Commission  
Utilities Division – Docket Control  
1200 W. Washington Street  
Phoenix, Arizona 85007

Copy of the foregoing hand-delivered  
this 29th day of May, 2015, to:

- 1 Steve Olea  
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- 6 Janice Alward, Chief Counsel,  
7 Legal Department  
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10 Copy of the foregoing mailed  
this 29th day of May, 2015, to:
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